

Nos. 22634, 22634-A

IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

5236
V. 2-1-68

ESTATE OF JOHN F. NUTT, Deceased,
Eileen M. Nutt and Frances D. Nutt,
Executrixes,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

EILEEN M. NUTT,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF FOR PETITIONERS

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BRIEF FOR PETITIONERS

ON PETITIONS FOR REVIEW OF THE DECISIONS OF
THE TAX COURT OF THE UNITED STATES

OPINIONS BELOW

The findings of fact and opinions of the Tax Court of the United States, filed October 26, 1962 and August 18, 1967, are reported at 39 T.C. 231 and 48 T.C. No. 71, and are found in Volume 1 of the record herein at page 192, Volume 2 of the record herein at page 441.

JURISDICTION

This appeal involves Federal income taxes. By separate notices of deficiency, both dated September 4, 1958, one being addressed to John F. Nutt and the other to Eileen M. Nutt, the Commissioner of Internal Revenue determined deficiencies as follows:

	<u>John F. Nutt</u>	<u>Eileen M. Nutt</u>
1955	\$20,795.45	\$20,699.45
1956	43,060.09	42,604.09
1957	38,806.03	38,806.04 (R.I-18, 31).

Separate petitions were filed with the Tax Court of the United States on November 24, 1958. (R.I-1, 25). Each petition sought a redetermination of the deficiencies set forth in the respective notices of deficiency. (R.I-1, 25). The decisions of Tax Court entered on April 18, 1963 determined deficiencies in income taxes as follows:

	<u>John F. Nutt</u>	<u>Eileen M. Nutt</u>
1955	\$10,045.34 (overpayment)	\$ 9,601.34 (overpayment)
1956	37,511.38	37,073.38
1957	46,747.12	46,747.12 (R.I-333, 334).

These cases were brought to this Court by separate petitions for review filed July 11, 1963. (R.I-335, 341, 237). On November 22, 1967, the cases were remanded to the Tax Court for proceedings in accordance with this Court's opinion filed October 1, 1965 and reported at 351 F. 2d 452 (9th Cir. 1965).

The Tax Court, after further proceedings pursuant to the remand,

entered its decisions on December 12, 1967 determining the deficiencies to be as follows:

	<u>John F. Nutt</u>	<u>Eileen M. Nutt</u>
1955	\$10,045.34 (overpayment)	\$ 9,601.34 (overpayment)
1956	37,511.38	37,073.38
1957	46,747.12	46,747.12 (R. 2-552, 553).

The cases were again brought to this Court by separate petitions for review filed on the 8th day of January, 1968. (R. 2-554, 562). The jurisdiction of this Court to review the aforesaid decisions of the Tax Court is founded on Sections 7482 and 7483 of the Internal Revenue Code of 1954.

STATEMENT OF THE CASE

This controversy involves the proper determination of the separate income tax liability of John F. Nutt, deceased, on the one hand, and Eileen M. Nutt, on the other hand, for the years 1955, 1956 and 1957.

During 1955, petitioners owned, as community property, approximately 2,400 acres of farm land near Eloy, Arizona. (R.I-195-196). The land was used to grow several types of crops among which was cotton. (R.I-196, 201). In addition to the 2,400 acres of fee land, petitioner John F. Nutt held leases on other farm land in the vicinity owned by four other persons. (R.I-197).

On August 30, 1955 petitioner John F. Nutt and petitioner

Eileen M. Nutt each sold his and her respective community interest in approximately 1, 142 acres of the said 2, 400 acres to Rancho Tierra Prieta, an Arizona corporation. (R.I-200). At the time of the sale, a growing cotton crop was affixed to the 1, 142 acres. (R.I-200).

Neither the deed of conveyance nor the August 30, 1955 written agreement of sale between petitioners and Rancho contained any provision granting either of the petitioners separately or both petitioners jointly an option to reacquire the 1, 142 acres so conveyed. (R.I-201). The gain realized on such sale by each petitioner was reported on the installment basis as capital gain on each's separate income tax returns for the years involved. (R.I-217).

When the respective community interests in the 1, 142 acres and unharvested cotton crop were sold to Rancho on August 30, 1955, the outstanding stock of Rancho was owned as follows:

Stockholder	Class of Stock	No. of Shares
John F. Nutt	Common voting	75
Eileen M. Nutt	Common voting	75
Norman Nupen	Preferred nonvoting	1
Charles N. Walters	Preferred nonvoting	1 (R.I-199).

Thereafter, on August 20, 1956, John F. Nutt and petitioner Eileen M. Nutt each sold his and her respective community interest in 942.5 acres of land and the unharvested cotton crop thereon to Rancho. (R.I-234).

Neither the deed of conveyance nor the August 20, 1956

written agreement of sale between petitioners and Rancho contained any provision granting either of the petitioners separately or both petitioners jointly an option to reacquire the 942.5 acres so conveyed. (R.I-205). The gain realized on such sale by each petitioner was reported on the installment basis as capital gain on each's separate income tax returns for the years involved. (R.I-212).

Later the Commissioner of Internal Revenue, in separate statutory notices of deficiency issued to John F. Nutt and to Eileen M. Nutt for the taxable years 1955 through 1957, adopted the theory that all of the income realized by Rancho from the 1955 and 1956 cotton crops "is in reality the income of John F. Nutt and Eileen Nutt." (R.I-20, 44). That is, the Commissioner's sole ground was that the transaction was a sham and must be disregarded.

In addition to the sales by each petitioner of his and her community interest in the 1,145 acres and unharvested cotton crop during 1955 to Rancho, John F. Nutt also sold to an Arizona corporation named Black Land Farms, Inc., the aforesaid leases. At the time of the sale, a growing crop was affixed to said leased land. The gain realized upon the sale of such leaseholds was reported on the installment basis as capital gain in the separate income tax return filed by John F. Nutt and by Eileen M. Nutt for the years involved. (R.I-217). The capital gain was claimed by each return on the ground that the leaseholds constituted "capital assets". (Exh. 4-D at 6 and Exh.7-G at 4).

written agreement of sale between petitioners and Rancho contained any provision granting either of the petitioners separately or both petitioners jointly an option to reacquire the 942.5 acres so conveyed. (R.1-205). The gain realized on such sale by each petitioner was reported on the installment basis as capital gain on each's separate income tax returns for the years involved. (R.1-212).

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Later in the same separate notices of deficiency referred to above, the Commissioner adopted the theory that all income realized by Black Land from the 1955 cotton crop grown on the said leased land "is in reality the income of John F. and Eileen Nutt." (R.I-20, 44).

Subsequently, separate petitions were filed by John F. Nutt and Eileen M. Nutt in the Tax Court on November 24, 1958. (R.I-1.25).

Thereafter, just a few days prior to a trial setting, after voluminous stipulations of fact had been prepared, the Commissioner filed a motion for leave to file an amended answer in each case, and filed an amended answer in each case. (R.I-56-57, 75-80). The said amended answers each departed from the ground set forth in the notices of deficiency and pleaded affirmatively the new theory that capital gain treatment should be disallowed on the sales of land and unharvested crop on the ground that John F. Nutt and also Eileen M. Nutt each retained a direct or indirect right to reacquire the land. (R.-76, 81). Additionally, the Commissioner pleaded affirmatively the new theory that the sale of leaseholds must be denied capital gain treatment because a leasehold is not considered as "land" to qualify for capital gain treatment permitted under Section 1231 (b) (4). (R.I-76, 81).

At the trial, the cases were consolidated for hearing.

The Tax Court held that while there was no case dealing with the Commissioner's regulation that Section 1231 (b) (4) does not apply to the "sale" of "an unharvested crop if the taxpayer retains any right or

option to reacquire the land the crop is on directly or indirectly", the indirect right existed "because petitioners were the sole holders of voting stock of Rancho." (Underscoring supplied) 39 T.C. 231, 252.

It analogized the instant case to the situations where there were dealings between "a sole stockholder and his corporation," and concluded that the existence of several specific and precise provisions dealing with transactions between a shareholder owning more than a stated percentage of corporate stock and a related corporation did not prevent a general rule requiring other special treatment of transactions between a "sole stockholder and his corporation." 39 T.C. 231, 253.

The Tax Court also held, even though petitioners had never claimed that a sale of leaseholds constituted a sale of land and unharvested crop under Section 1231(b)(4), that such leaseholds did not constitute land within the meaning of Section 1231(b)(4). 39 T.C. 231, 251.

Subsequently, John F. Nutt and also Eileen M. Nutt filed separate Petitions for Review. (R. I-231-237). Each argued: that the Tax Court's ruling that a leasehold was not land within the meaning of Section 1231 (b) (4) "so as to qualify for the capital gain treatment permitted" thereunder begged the whole issue of whether a leasehold was a capital asset under Section 1231 (b) (1)'s definition of "property used in the trade or business"; that concedely the leaseholds were not "land" within the meaning of Section 1231 (b) (4); and that since leaseholds held for more than six months were "property used in the trade or business" within the meaning of Section 1231 (b) (1), the gain therefrom is taxed as capital gain.

This Court's opinion of October 1, 1965, briefly held that its opinion in Bidart Bros. v U.S., 262 F. 2d 607, interpreting the word "land" as used in Section 1231 (b) (4) "completely precludes petitioners here." 351 F. 2d 452, 453.

In the same appeal to this Court, John F. Nutt and also Eileen M. Nutt also contended that the Commissioner's restricted interpretation of the term "sale" as found in Section 1231 was based on an unlawful regulation, and that even if a valid regulation, the Tax Court erred in concluding that each petitioner had retained an indirect right to reacquire the land from Rancho because together they owned all of the common stock of Rancho. Thus, each petitioner contended that each was entitled to capital gain treatment on their respective sales of their community interests in the land and unharvested crops.

This Court's opinion of October 1, 1965 remanded the case to the Tax Court for findings as to how the stock was owned and what were the incidents of such ownership. In so doing it noted that under Section 10-231 of the Arizona Revised Statutes "Eileen M. Nutt could have disposed of the stock registered in her name" and "John Nutt could have sold the stock registered in his name." 351 F. 2d 452, 454.

Subsequently, the Tax Court ruled that the 75 shares of stock in John F. Nutt's name and the 75 shares of stock in Eileen Nutt's name was community property, and that the stock registered in the name

of Eileen Nutt could be managed and controlled by John F. Nutt who could "vote the stock to dissolve the corporation and declare the land petitioners had sold to it as a dividend" or sell all of Eileen's stock to the corporation thereby leaving him as the registered owner of all the stock after which he could declare a dividend of the land or "sell the land to himself as community property."

Later the Tax Court denied petitioners' motion to reopen to receive a ruling of the Superior Court of Pinal County that the 75 shares of Rancho stock owned by John Nutt was the separate property of John Nutt. (R.II-475, 550-551).

These appeals followed.

SPECIFICATIONS OF ERRORS RELIED UPON

1. The Tax Court erred in finding that the stock owned by John F. Nutt, deceased, was community property.
2. The Tax Court erred in finding that the stock owned by Eileen M. Nutt was community property.
3. The Tax Court erred in holding that Commissioner of Internal Revenue overcame the presumption that the Rancho stock held by each taxpayer was the separate property of John F. Nutt and Eileen M. Nutt respectively.
4. The Tax Court erred in finding that the taxpayers had no agreement that the stock would be held by each as separate property.
5. The Tax Court erred in holding that the taxpayer John F.

Nutt, deceased, could, either directly or indirectly, reacquire the property conveyed to Rancho.

6. The Tax Court erred in holding that taxpayer Eileen M. Nutt could, either directly or indirectly, reacquire the land deeded to Rancho.

7. The Tax Court erred in holding that the community of John F. Nutt and Eileen M. Nutt was the taxable entity herein in complete disregard of the fact that it is the income tax liability of separate taxpayers, John F. Nutt and Eileen M. Nutt, which is involved.

8. The Tax Court erred in holding that John F. Nutt had the legal right to vote the stock held in the name of Eileen M. Nutt.

9. The Tax Court erred in holding that John F. Nutt had control of all the voting stock of Rancho and therefore had complete dominion over Rancho and could reacquire the land.

10. The Tax Court erred in interpreting the word sale in Section 1231 pursuant to U.S. Treas. Reg. 1.1341-1 (f).

11. The Tax Court erred in not reopening the case for further evidence on the question of how the stock of the corporation was owned.

ARGUMENT

The applicable rule of law, according to 10 Mertens, Law of Federal Income Taxation, § 58 A. 35, at page 98, is that:

"... when the Commissioner departs from the grounds relied on in his statutory deficiency notice to sustain a theory later raised, he had the burden of proving any new matter raised."

Cases so holding are Massingale v. United States, 59-1 U.S.T.C. Par. 9298 (D.C. Ariz. 1959) and Service Life Ins. Co. v. U.S., 189 F. Supp. 282 (D.C. Neb., 1960), aff'd 8 Cir., 1961, 293 F.2d 72.

Therefore, having departed from the ground relied on in each notice of deficiency - that Rancho's and Black Land's income from the cotton crops was in reality the income of John F. Nutt and of Eileen M. Nutt - the Commissioner of Internal Revenue had the burden of proving the new matter raised in its amended answers to the effect that each petitioner had retained an indirect right to reacquire the land purchased by Rancho, and that leaseholds are not property used in the trade or business as specially defined in Section 1231 (b) (1).

As shown below the Commissioner has not even attempted to carry his burden of proving that Eileen M. Nutt had an indirect right to reacquire the land sold to Rancho. Rather, by persuading the Tax Court to rule that John F. Nutt had management and control over the stock of Eileen M. Nutt, he proved that Eileen M. Nutt did not have an indirect right to reacquire the land. That is probably why the Tax Court made no finding that Eileen M. Nutt had an indirect right to reacquire the land but referred only to the claimed indirect right of John F. Nutt. This factor, along with the Tax Court's error in ruling that the said stock owned by each was community property, and the other errors hereinafter set forth, show that petitioners were entitled to capital gain treatment on the sale of each's community interest in land and cotton sold. Also, for the reasons hereinafter set forth, each was entitled to capital gain treatment on the sale

of property used in the trade or business (leaseholds).

1

The Shares Of Rancho's Stock Owned By Taxpayers John F. Nutt, Deceased, And Eileen M. Nutt, Respectively, Were The Separate Property Of Each.

The Commissioner has contended and the Tax Court has found that the corporate stock owned by each petitioner is community property. The contention and the finding are based upon the premise that petitioners did not overcome the presumption under Arizona law that all property acquired during coveture is community property. For the reasons that follow petitioners submit that they have not only overcome the Arizona presumption but here also created a presumption of separate ownership which has not been overcome by the Commissioner.

A

The Shares Of Stock Were Issued To Each Taxpayer In His Or Her Separate Capacity By The Taxpayers As Officers Of The Corporation.

While Arizona law provides that property acquired by either spouse during coveture is presumptively community property, such presumption is not conclusive. Thus, under Arizona law, when a conveyance of property to either spouse separately is surrounded by circumstances which demonstrate an intention that the property be owned separately, it is generally held that the property belongs separately to the spouse to whom it is conveyed. In Jones v. Rigdon, 32 Ariz. 291, 257 Pac. 639

(1927), the Court was concerned with a question which is very relevant to the determination of the issue now before this Court. Arizona law, of course, under the doctrine of Erie R. Co. v. Tompkins, 304 U.S. 64 (1938) controls the determination in this Court. In Jones, supra, the Arizona Supreme Court in deciding whether a conveyance to the wife during coverture was community or separate property held that:

"The fact that a husband causes or permits a conveyance to be made to his wife tends to show that it was the intention of the parties that the property should be her separate estate... even where it appears the property was paid for with community funds. Contemporaneous conduct by the husband indicating his intention that his wife should have the property, coupled with the fact that the conveyance is to the wife is generally held conclusive that the property was intended to be her separate estate." (Underscoring supplied)

In this case, the stock was issued to each taxpayer individually, record title being in the separate names of John F. Nutt and Eileen M. Nutt, respectively. Separate shares of stock were issued to each of them reflecting individual ownership thereof and such separate ownership was recorded on the corporate stock registries. (Exs. 9, 43).

The above issuance and recordation was contemporaneous with the conveyance of the stock to each taxpayer as an individual. (Exs. 9, 43) Mr. and Mrs. Nutt, as officers and directors of the corporations, directly participated in the issuance and registry of the stock, the ownership of which is now in question. The taking of the stock in the separate names of each taxpayer, in addition to the contemporaneous conduct of the parties, including but not limited to direct participation in the issuance and registry of the stock, not only overcame the presumption

that such stock was community property but also established under Arizona law a presumption that the property belonged to the respective separate estate of each taxpayer. Jones v. Rigdon, supra; Martha Locke Shoenhair, 45 B.T.A. 576 (1941); Edwin M. Peterson, 35 T.C. 962 (1961).

While the funds with which the stock was originally purchased from the corporations were community property of the taxpayers, the community interest of each spouse in the funds was, under Arizona law, validly and effectively conveyed as separate interest in the stock, thus changing the character of the property from community to separate. Martha Locke Shoenhair, supra. (The Commissioner's Opening Brief on Remand p. 19). It is, in addition, a matter of record that John F. Nutt issued the stock certificates, signing them as President of Rancho. The entire conduct of the parties, when coupled with the issuance of the stock in the taxpayer's separate names, shows that it was the intention of the taxpayers that the stock should be the separate property of the husband and wife, respectively. In other words, the fact that one-half of the stock was issued and registered in the name of Eileen M. Nutt coupled with the fact that John F. Nutt directly caused the stock to be issued and registered in her name overcame the presumption of community property and established a conclusive presumption that the stock was intended to be her separate property even if it had been purchased with community funds. Conversely, the fact that Mrs. Nutt, as

Secretary of the corporations, caused the other one-half of the stock to be issued in the name of her husband gave rise to a conclusive presumption that she intended that stock to be his separate property even though it had been paid for with community funds. (Exs. 9, 43)

The Commissioner did not overcome the presumptions which arose that the corporate stock was the separate property of Eileen M. Nutt and John F. Nutt, respectively. The contentions that the said stock was community property is without merit and the Tax Court's finding to that effect is erroneous.

II

The Taxpayer Eileen M. Nutt Is Entitled To Capital Gains Treatment On The Income Derived From Her Sale Of Land And The Crops Thereon To Rancho Because The Sale Is Within Section 1231 (b) (4) Of Internal Revenue Code Of 1954.

Taxpayer Eileen M. Nutt, in August of 1955 and again in August of 1956, sold to Rancho her community interest in land and an unharvested cotton crop. The gain derived from the sales was reported on the installment basis as capital gain. The government has sought to demonstrate that the taxpayers may indirectly reacquire the land and that the sale therefore comes within the provisions of U.S. Treasury Regulation § 1.1231 - (f) (1954) which provides that section 1231 (b) (4) does not apply to a sale where the seller retains the right to reacquire the land. The government has not sought to demonstrate that the taxpayer Eileen M. Nutt may, either directly or indirectly, by

her own acts, reacquire the land. Yet such a showing is necessary if the deficiency assessed against her is to stand on the ground that she has the right to reacquire the land.

Preliminarily it must be emphasized that here we are concerned with two separate taxpayers, not one. Therefore, the question with which we deal is whether each taxpayer can control Rancho in such a way as to reacquire the interest in land deeded to the corporation by that taxpayer.

A.

Assuming Arguendo That The Stock Held By Each
Petitioner Was Community Property, Eileen M. Nutt Cannot Deal
With The Community Interest Registered In Her Husband's Name And
Therefore She Cannot Reacquire The Land.

Assuming arguendo that the 75 shares of Rancho stock held by Eileen M. Nutt and the 75 shares of Rancho stock held by John F. Nutt were each community property, the wife cannot, except with regard to certain statutory exceptions and allowances not here relevant, deal with her husband's interest in the community property in any manner whatsoever. Eileen M. Nutt's incapacity to dispose of community personal property is set forth by statute as follows:

"During coveture, personal property may be disposed of by the husband only." A.R.S., Sec. 25-211 B.

This being true Eileen M. Nutt has no capacity to reacquire the land

where the stock is deemed owned by the marital community of John F. Nutt and Eileen M. Nutt.

B.

Assuming That The Stock Is The Separate Property

Of Each Petitioner, Eileen M. Nutt Cannot Deal With The Stock Which Belongs To John F. Nutt And Therefore Cannot Reacquire The Land From Rancho.

The truth of the above proposition is not subject to serious challenge. The Commissioner has never sought to show that Mrs. Nutt could in any way deal with the stock of John F. Nutt. Instead it has consistently tried to show that the stock held by each was community property.

If the stock was held by each taxpayer as his or her separate property, there is no dispute that Mrs. Nutt could deal with her property without consulting with or receiving permission from Mr. Nutt. Therefore, she could sell, vote, manage and control her shares in any manner deemed appropriate by her. However, given this legal ability, she would not be in a position to reacquire any interest in the land conveyed to Rancho since under the law of Arizona Mrs. Nutt could not dissolve the corporation unless she owned or controlled 66 2/3% of the voting shares. A.R.S., Sec. 10-361. It cannot be said that Mrs. Nutt retained the right to reacquire the interest in land conveyed to the

corporation merely because she, along with her husband, owned 100% of the corporation's voting stock. For example, suppose five sellers, none related to the other, each owned 20% of the land and crops sold and also 20% of the voting stock of the purchasing corporation. How could any one of these sellers have an indirect right to reacquire the land ? The "right" of each is dependent upon the actions of the others. If the proper number of other shareholders refused to vote their shares so as to allow the individual shareholders the right to reacquire the land, how could each obtain that interest in land? What sort of "right" exists if it is dependent upon the prior approval of others?

Here Eileen M. Nutt sold a one-half interest in lands and crops to Rancho, and received payment therefor. At the time of such sale, she was the separate owner of one-half of Rancho's voting stock, and the same was true with respect to her husband John F. Nutt. Therefore, how does Eileen M. Nutt, the owner of 50% of the voting stock, compel Rancho to return her one-half interest in the land? Obviously, the Commissioner and the Tax Court have attempted to resolve this burden by treating the two taxpayers, Eileen M. Nutt and John F. Nutt, as if they were one person. That is, they are attempting to apply some rule, not found in the Internal Revenue Code, that related parties, a husband and wife, are deemed to own and have control of stock owned by each other. It is also of interest to note that such a result would not even be attempted by the Commissioner in a non community property

state, and that therefore he is attempting to discriminate against those taxpayers who are citizens of community property states.

Therefore, whether Eileen M. Nutt held her 50% stock interest in Rancho as sole and separate property or as community property, she could not, by virtue of that ownership, reacquire her one-half interest in the land conveyed to Rancho. Therefore, pursuant to the provisions of Section 1231 Eileen M. Nutt is entitled to capital gain treatment on the gain derived from the sale to Rancho of her interest in the lands and crops regardless of whether John F. Nutt would or would not be entitled to capital gains treatment on the sale of his interest. That is, there is an important distinction to be drawn here. It is one thing to conclude that John F. Nutt had control over the stock in Eileen M. Nutt's name and that therefore he could reacquire the land, but it is an entirely different matter to conclude from such a finding that Eileen M. Nutt had an indirect right to reacquire the land. The two are mutually exclusive. If John F. Nutt had such right because he had dominion and control over the stock in Eileen M. Nutt's name, the other side of the coin is that Eileen M. Nutt could not have had such dominion and control over the stock held in John F. Nutt's name and/or her own name. The Tax Court cannot have it both ways, and the finding that John F. Nutt as manager of the community had control over the stock held in the name of Eileen M. Nutt excludes a finding that Eileen M. Nutt had the control

over her own and John F. Nutt's stock sufficient for her to reacquire her interest in the land and crops. How would she ever reacquire such interest, whether the stock was held as community property or as the sole and separate property of each, unless her husband agreed to vote the stock in such a manner as to permit the reacquisition of the land?

III

The Estate Of John F. Nutt Is Entitled To Capital Gain Treatment On The Gain Derived By His Sale Of Land And Crop To Rancho Since The Sale Is Within The Meaning Of Section 1231 (b) (4).

Again, as in the case of Eileen M. Nutt, it should be pointed out that we are dealing with two separate taxpayers. The question then is whether John F. Nutt could control a number of shares in Rancho sufficient to dissolve the corporation and distribute its assets, namely the land, to its shareholders or to himself.

John F. Nutt also sold an interest in land to Rancho and reported the gain therefrom on the installment basis as capital gain. With respect to John F. Nutt the Commissioner and the Tax Court have sought to show that he could (assuming the stock was community property) , by the management and control of his wife's interest granted him under Arizona law, reacquire the land either for himself or for him and his wife. However, whether the stock held by each is deemed community property or the sole and separate property of each, John F. Nutt did not have the control over his wife's stock so that he could reacquire the land.

Assuming Arguendo, As The Commissioner Contends, That The Stock Is Community Property Of The Petitioners, Mr. Nutt Cannot Effectively Deal With The Stock Held In His Wife's Name.

The Commissioner contends that, under Arizona law, only John F. Nutt "could manage, control and dispose" of the corporate stock, one-half of which was registered in his wife's separate name. This contention is premised upon an assumption that the corporate stock was community property and upon an Arizona statute which provides: "During coverture, personal property may be disposed of by the husband only." A.R.S., Sec. 25-211 B. However, as Judge Chambers noted in his opinion remanding this case to the Tax Court, "Under Section 10-231 of the Arizona Revised Statutes Eileen M. Nutt could have disposed of the stock registered in her name." ¹ Therefore, the Commissioner's contention that only John F. Nutt could dispose of the corporate stock is obviously incorrect.

The suggestion which the Commissioner has made that John F. Nutt could dispose of the stock registered in the separate name of Eileen M. Nutt and that she (Mrs. Nutt) would be estopped from challenging

¹ By specific statutory provision Sec. 10-231 is deemed to have repealed Sec. 25-211 B in this respect. A.R.S., Sec. 1-245.

the validity of such a transfer is also incorrect. The stock certificates which were issued in the separate name of Eileen M. Nutt could be transferred only if she (Mrs. Nutt) first endorsed either the certificates or a written assignment or power of attorney to sell, assign, or transfer said share. A.R.S., Sec. 10-231. Therefore, John F. Nutt, qua husband, could not have disposed of the stock certificates in the separate name of Eileen M. Nutt (even if the said shares are held to be community property). To do so, he would first have had to obtain the consent of Mrs. Nutt to such a transfer evidenced by her endorsement of either the stock certificates or a written power of attorney or assignment.

Furthermore, it is also erroneous to suggest that as "head and master of the community" or "through the husband's absolute managerial power and control over the stock" John F. Nutt could have forced Mrs. Nutt to consent to a disposition by him of the said stock or to vote it as he directed. Such contention stems from a confusion of "might" with "right" based upon a misunderstanding of the basic principles of community property law and upon an erroneous idea of the wife's ownership and the husband's administrative control or power. In Goodell v. Koch, 282 U.S. 118 (1930) the Supreme Court, after a discussion of such basic principles of Arizona community property law, held that "... Power is not synonymous with right...." and rejected the government's argument made therein that because the husband, under Arizona community property law, had absolute management power and control over the community income, he had the right to do with it as he pleased and

should, therefore, be treated as the taxpayer to whom it was taxable in its entirety. In discussing the arguments that had been made by the government in Goodell v. Koch, supra, and companion cases, deFuniak, in Volume 1 of his treatise "Principles of Community Property", at pages 676-7 states:

"The chief error in these arguments as to the husband's 'control' and 'enjoyment' or 'benefit' of the income rests in the fact that the ones advancing these arguments are looking at this 'control' by the husband in the light of what such control is under the common law, where the control of the husband has unquestionably been one which he might exercise to his own use, enjoyment and benefit, to whatever extent he might choose. The use of common law standards as a means of interpreting the community property law is a common error...." (Underscoring supplied).

After explaining that the ownership of the wife in community property is equal in every respect to that of the husband and that the 'control' of the community property entrusted to his care is merely that of a statutory administrator, deFuniak goes on to say, at pages 677-680:

".... These are primary and basic principles of community property law. There is nothing corresponding to them in the common law where a 'control' vested in the husband is an absolute thing. It is the worst and most misleading thing one can do, to look at the word 'control' as it appears in connection with the community property law and then to interpret it and consider it in the light of common law experiences and to disregard the full force of the equal property concepts firmly embedded in the community property system. Yet it is the mistake most commonly committed by legal writer after legal writer, by lawyer after lawyer....

The Supreme Court of the United States has not, however, fallen into these errors and has clearly grasped the completeness and equality of the wife's ownership under the community property law and that the husband's duty of management or administration of the community property is equivalent merely to

that of a managing agent or partner for the benefit of the conjugal partnership. This it determined by unanimous opinion in the test cases brought before it from Washington, Arizona, Texas and Louisiana, particularly expressing its reasoning in the case of Poe v. Seaborn ...² (Underscoring supplied).

The foregoing principles have also been followed by the Tax Court in Arizona Publishing Co. 9 T.C. 85, 88 (1947) and Edwin M. Petersen, supra, wherein it was held that where possession and control over community property stems from a fiduciary relationship, the power of management thereof is not to be considered equivalent to complete dominion or control over the property by the managing spouse.

Therefore, the contention that because of his "absolute" power of management John F. Nutt could have forced Mrs. Nutt to consent to a disposition by him of the stock or that he could have directed her to vote it as he wished is without merit.

Section 25-211 B of the Arizona Revised Statutes provides:

"During coverture, personal property may be disposed of by the husband only." (Underscoring supplied).

Section 10-231 of the Arizona Revised Statutes, on the other hand, provides:

"A. Title to a certificate and to the shares represented thereby can be transferred only:

1. By delivery of the certificate endorsed either in blank or to a specified person by the person appearing by the certificate to be the owner of the shares represented thereby.

² The case of Poe v. Seaborn cited in the quoted materials is found at 282 U.S. 101 (1930).

2. By delivery of the certificate and a separate document containing a written assignment of the certificate or a power of attorney to sell, assign or transfer the certificate or the shares represented thereby, signed by the person appearing by the certificate to be the owner of the shares represented thereby. Such assignment or power of attorney may be either in blank or to a specified person." (Underscoring supplied).

In other words, as Judge Chambers concluded: "Under Section 10-231 of the Arizona Revised Statutes Eileen Nutt could have disposed of the stock registered in her name." (Footnote 5 of the opinion of the Court of Appeals remanding this case.) Obviously a conflict exists, and is subject to the provisions of Section 1-245 of the Arizona Revised Statutes which provides:

"When a statute has been enacted and has become a law, no other statute or law is continued in force because it is consistent with the statute enacted, but in all cases provided for by the subsequent statute, the statutes, laws and rules theretofore in force, whether consistent or not with the provisions of the subsequent statute, unless expressly continued in force by it, shall be deemed repealed and abrogated."

In addition to the said statutory mandate, the Arizona Supreme Court has held that, as a matter of statutory construction, the Arizona rule is that where a subsequent act of the legislature is in conflict with a prior act, it by implication repeals so much of the prior act as is in conflict with the latter act. City of Bisbee v. Cochise County, 44 Ariz. 233, 36 P. 2d 559 (1934).

Petitioners submit that Section 10-231 of the Arizona Revised Statutes had repealed Section 25-211 B so that, for all practical purposes, it now provides: "During coverture, personal property may be disposed

of by the husband only, except for corporate stock issued in the separate name of the wife."

B

Assuming, As Petitioners Contend, That The Stock Is The Separate Property Of Each Petitioner, Mr. Nutt Could In No Way Deal With Or Control The Stock Belonging To Mrs. Nutt.

The argument set forth in II B above is equally applicable to petitioner John F. Nutt. Under the provisions of Arizona law,

"B. Married women have the sole and exclusive control of their separate property. The separate property of a married woman is not liable for debts or obligations of the husband, and it may be sold, mortgaged, conveyed or bequeathed by the woman who owns it as if she were not married." A.R.S., Sec. 25-214 B. (Underscoring supplied).

Thus there is no legal way that this petitioner could control the voting of Mrs. Nutt's separate property so as to secure voting strength in himself sufficient to reacquire the land originally deeded to Rancho. A.R.S., Sec. 10-361, supra.

For the foregoing reasons, petitioners respectfully submit, it should be concluded, as a matter of law, that neither Eileen M. Nutt nor John F. Nutt had the right or option to reacquire the land sold to the corporation.

IV

The Tax Court Erred In Refusing To Re-Open The Case Below So That "Proper Regard" Might Be Given To The Case Of Estate Of John

It has long been established by the Supreme Court of the United States that until a case has been fully adjudicated on direct appeal, consideration must be given to supervening decisions which are relevant and material to the merits of the controversy. Vandenbark v. Owens-Illinois Glass Co., 311 U.S. 538 (1940) and cases cited therein. Application of the said rule has resulted in remand of cases to the Circuit Court of Appeals for reconsideration in the light of a supervening decision,³ as well as to the Tax Court where it appeared that the taxpayer may want to introduce further evidence in the light of the relevant supervening decision.⁴

The mandate in such cases directed a reconsideration and/or rehearing in the light of the supervening decision, and thus removed the question of whether or not the matter should be reconsidered and/or reheard from the province of the lower court's discretion. As a result the Circuit Courts of Appeals give consideration to an intervening decision

3

See, eg., Blaauw v. Grand Trunk Western R. Co., 380 U.S. 127 (1965), which was remanded to the Seventh Circuit for reconsideration in the light of a supervening Illinois Appellate Court decision that was entered four months after entry of a decision by the Circuit Court and while petition for Certiorari was pending.

4

See, eg., Helvering v. Richter, 312 U.S. 561 (1941); Hormel v. Helvering, 312 U.S. 552 (1941).

brought to the Court's attention even though such decision was handed down while the appeal in the case before it was pending. See, eg., Dindo v. Grand Union Co., 331 F. 2d 138, 140 n. 1 (2d Cir. 1964).

Petitioners submit that, before reaching its decision in this case, the Tax Court was bound to give consideration to two judicial decisions which, although entered after the instant cases were submitted (but prior to the entry of the decision), are relevant and material to the disposition of one of the issues involved herein.

On June 5, 1967, the Supreme Court of the United States entered its decision in Commissioner v. Estate of Bosch, 387 U.S. 456 (1967).

Therein it confronted the problem of what effect must be given to a non-adversary⁵ state trial court decree wherein a determination has been made respecting the character of a property interest on the resolution of a federal tax controversy turning upon the characterization, pursuant to state law, of said property interest. The court held that al-

⁵ The non-adversary nature of the state trial court proceedings involved in Bosch is substantiated as follows: In his brief the Commissioner (as petitioner) stated the "Question Presented" to be:
"When the resolution of an issue in a federal estate tax controversy depends upon the character of a property interest owned or transferred by the decedent and the character of such interest has been determined in a non-adversary State trial court proceeding to which the United States was not a party, is the Federal court conclusively bound by that decision even though it is contrary to State law?" (Underscoring supplied). At pages 32-33 of his brief, the Commissioner then argued that "the State trial court proceedings were clearly non-adversary". The Supreme Court apparently agreed. It stated the position of the Government to be "that a state trial court adjudication is binding in such cases only when the judgment is the result of an adversary proceeding in the state court." (387 U.S. at 463). Obviously, if the state trial court proceedings involved in Bosch had been adversary in nature, the appeal therein would have been moot in the light of the issue framed by the Commissioner for review by the Supreme Court.

though the Tax Court (or any other federal court) is not conclusively bound by the state trial court's adjudication, it cannot ignore the decision and must give "proper regard" thereto in the course of its ascertainment of the applicable state law.

On July 31, 1967 the Superior Court of the State of Arizona in and for the County of Pinal entered an order declaring one-half of the corporate stock involved herein to be the separate property of John F. Nutt. Because the issue involved herein is determined in favor of petitioners if the property is separate, the relevancy and materiality of the said decision is apparent.

Thus, since the Supreme Court held in Bosch, supra, that the Tax Court must give "proper regard" to such a relevant ruling of a state trial court even though entered in a so called non-adversary proceeding, it follows that the Tax Court should have, in the course of ascertaining the applicable Arizona law, given consideration to the said ruling of the Arizona Superior Court. The Supreme Court has made it abundantly clear that the said Arizona decision cannot be ignored or brushed aside.

The necessity that the cases be reopened in the Tax Court for the taking of further evidence stems from the fact that the relevant ruling of the Arizona Superior Court is unreported and, therefore, certified copies thereof should have been admitted for the record.

In conclusion Bosch, supra, dictates that "proper regard" be

given in the Tax Court to state trial court decisions. Obviously "proper regard" cannot be given to matters not before the court. Therefore, the Tax Court erred in refusing to reopen the case for introduction of evidence material and relevant to the determination of applicable Arizona law on a question the answer for which this Court remanded the matter to the Tax Court: how was the stock of the taxpayers in Rancho owned by them?

V

The Limitation On The Word "Sold" Used In Section 1231 (b) (4), As Found In U.S. Treas. Reg. 1. 1231-1 (f), Is A Clear Violation Of The Doctrines Enunciated In Commissioner v. Brown, 380 U.S. 563 (1965).

By ruling that the word "sold" found in Section 1231 (b) (4) is restricted if each seller retains an indirect right to reacquire the land sold to Rancho, the Tax Court has violated the clear doctrines laid down in Commissioner v. Brown, 380 U.S. 563 (1965).

The case of Commissioner v. Brown, 380 U.S. 563 (1965), was, as the opinion stated at page 566, one of the many in the course of which the Commissioner of Internal Revenue questioned whether there had been a sale within the meaning of the Internal Revenue Code. In fact, when the Commissioner petitioned for a writ of certiorari, after this Court had held there was a sale, he told the Supreme Court therein that it was

one of the most important tax cases that had ever come to the Court, that "there now exists among the lower courts no core of agreement even as to the most generalized concept of what a sale meant," and that the Supreme Court should tell the lower courts what the word "sale" meant as used in the Internal Revenue Code. (Tr. 639-640). The Supreme Court took the case.

In the briefs filed by the parties, it was pointed out to the Supreme Court that the approach the Commissioner was attempting by giving the word "sale" a different meaning in federal tax law than its ordinary meaning, was affecting a multitude of transactions and had a host of adverse effects because the word "sale" appeared over 600 times in subchapter A alone.

The Supreme Court then responded to the Commissioner's petition that it tell the lower courts what the word "sale" meant as used in the Internal Revenue Code.

First, it noted, at page 570 of its opinion, the Commissioner's argument:

"Whatever substance the transaction might have had, however, the Commissioner claims that it did not have the substance of a sale within the meaning of § 1222 (3). His argument is that since the Institute invested nothing, assumed no independent liability for the purchase price and promised only to pay over a percentage of the earnings of the company, the entire risk of the transaction

remained on the sellers. Apparently, to qualify as a sale, a transfer of property for money or the promise of money must be to a financially responsible buyer who undertakes to pay the purchase price other than from the earnings or the assets themselves or there must be a substantial down payment which shifts at least part of the risk to the buyer and furnishes some cushion against loss to the seller." (Under-scoring supplied).

Next, the Supreme Court rejected the above argument, and gave its reasons:

" . . . This argument has rationality but it places an unwarranted construction on the term 'sale', is contrary to the policy of the capital gains provisions of the Internal Revenue Code, and has no support in the cases. We reject it."

Immediately thereafter, the Supreme Court told the lower courts what the word "sale" meant as used in the Internal Revenue Code. It held:

" 'Capital gain' and 'capital asset' are creatures of the tax law and the Court has been inclined to give these terms a narrow, rather than a broad construction. *Corn Products Co. v. Commissioner*, 350 U.S. 46, 52. A 'sale', however, is a common event in the non-tax world; and since it is used in the Code without limiting definition and without legislative history indicating a contrary result,

its common and ordinary meaning should at least be persuasive of its meaning as used in the Internal Revenue Code. 'Generally speaking, the language in the Revenue Act, just as in any statute, is to be given its ordinary meaning, and the words 'sale' and 'exchange' are not to be read any differently.' Helvering v. Flaccus Leather Co., 313 U.S. 247, 249; . . . Commissioner v. Korell, 339 U.S. 619, 627-628; Crane v. Commissioner, 331 U.S. 1, 6; Lang v. Commissioner, 289 U.S. 109, 111; Old Colony R. Co. v. Commissioner, 284 U.S. 552, 560.

" 'A sale, in the ordinary sense of the word, is a transfer of property for a fixed price in money or its equivalent, ' Iowa v. McFarland, 110 U.S. 471, 478; it is a contract to pass rights of property for money, -- which the buyer pays or promises to pay to the seller . . . , 'Williamson v. Berry, 8 How. 495, 544. Compare the definition of 'sale' in § 1 (2) of the Uniform Commercial Code. The transaction which occurred in this case was obviously a transfer of property for a fixed price payable in money." (Underscoring supplied).

Thus, the Supreme Court flatly rejected the government's argument that the term "sale" as used in the Internal Revenue Code is to receive some special interpretation reserved only for federal tax law, and ruled that the term "sale" is to be given its ordinary meaning -- a transfer of property for a fixed price in money or its equivalent.

Applying here the Supreme Court's definition of "sale" as a transfer of property for a fixed price in money or its equivalent, it follows that each of the petitioners sold his and her community interest in the land and crops to Rancho. Therefore, since the effect of U.S. Treas. Reg. 1.1231 - 1 (f) is to apply a restricted definition to the words "sale" and "sold", which violates Commissioner v. Brown, supra, the said regulation is unlawful. A sale is a sale whether or not the seller retains an indirect right to reacquire the property if there has been a transfer of property for a fixed price in money or its equivalent.

The error of the Tax Court's ruling upholding the validity of the said regulation is highlighted by its statement in its first opinion that its ruling was justified by the rule that the "definition of a capital asset must be narrowly applied." However, the Tax Court was not defining a capital asset but was ruling that the capital asset was not "sold" if the sellers retained an indirect right to reacquire the land. Thus, the application of such concept by the Tax Court was in error for that reason alone. Also, such application contradicts the holding in Commissioner v. Brown, supra, that the common and ordinary meaning of "sale" must be applied in federal tax law.

VI

Leaseholds Held For More Than 6 Months Are Entitled To Capital Gain Treatment On Sale As Property Used In The Trade Or Business Within The Meaning Of Section 1231 (b) (1), And Therefore It Is Immaterial Whether Or Not Leaseholds Are Land Within The Meaning Of Section 1231

(b) (4), A Section Whose Benefits Petitioners Have Never Claimed.

As set forth in the Statement of the Case, petitioners never claimed the benefits of Section 1231 (b) (4) when seeking capital gain treatment on the sale of leaseholds. Rather they pointed out that they were entitled to capital gain treatment from the sale of property used in the trade or business of a character subject to the allowance for depreciation as defined in Section 1231 (b) (1) because leaseholds held for more than 6 months constituted such property. The arguments with respect thereto found in Point II of petitioners' opening brief filed in this Court on the first appeal are incorporated herewith.

All petitioners wish to add by way of emphasis is that the "issue" of whether a leasehold is "land" within the meaning of Section 1231 (b) (4) is a manufactured "issue raised by the Commissioner's amended answers, and the answer thereto is irrelevant to the question posed by petitioners, which is whether or not leaseholds held for six months or more constitute property used in the trade or business of a character subject to depreciation as specially defined in Section 1231 (b) (1). If the answer to the latter question is yes, then petitioners are entitled to capital gain treatment on the sale of the leaseholds.

CONCLUSION

Each petitioner submits that the decision of the Tax Court should

be reversed.

Respectfully submitted,

MC LANE & MC LANE

William Lee McLane

By William Lee McLane

Nola McLane

Nola McLane

William A. Harrell

William A. Harrell

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19, and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Nola McLane

Nola McLane

Dated: May 31, 1968



EXHIBITS

NUMBER	IDENTIFIED	OFFERED	RECEIVED	REJECTED
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Respondent's:

II	19 *	20 *	20 *	
JJ	21 *	21 *	22 *	
KK	29 *	29 *	29 *	
LL and MM	40 *	40 *	40 *	
NN through XX	47 *	48 *	49 *	

Petitioners':

Exhibit A to Motion to Reopen				551 (R. -II)
Exhibit B to Motion to Reopen				551 (R. -II)

* Page references followed by * are to Transcript of Hearing at Los Angeles, California on November 9, 1966 before the Tax Court.

Note: Exhibits received in evidence during the first hearing of these cases are to be found in Appendix A of Brief for Petitioners, Nos. 18950-1 (the first appeal herein) which is incorporated herein by reference.

STATUTE INVOLVED

Internal Revenue Code of 1954:

Section 1231 (b) Definition of Property Used in the Trade or Business. - For purposes of this section -

(1) General rule. - The term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not -

* * * *

(4) Unharvested crop. - In the case of an unharvested crop on land used in the trade or business and held for more than 6 months, if the crop and the land are sold or exchanged (or compulsorily or involuntarily converted) at the same time and to the same person, the crop shall be considered as "property used in the trade or business".

